United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-7235

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 76-7235

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,
Plaintiff-Appellant,

—against—

H. ROSS PEPOT, ELECTRONIC DATA SYSTEMS CORPORATION, DUPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & Co., CHARLESTON INVESTMENT COMPANY, F. D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX,
Defendants-Appellees,

—and—

DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,
Defendants.

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF APPELLEE NEW YORK STOCK EXCHANGE, INC.

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On Appeal from the United States District Court for the Southern District of New York

BRIEF OF APPELLEE NEW YORK STOCK EXCHANGE, INC.

Statement of Issues for Review

1. Is the order of the District Court staying the action as to the New York Stock Exchange, Inc. (the "Exchange") pending conclusion of arbitration between appellant and certain other defendants (the "arbitrating defendants") appealable?

2. If appealable, does the order constitute an abuse of discretion in view of the District Court's finding that such a stay would serve to avoid duplicative effort and the possibility of inconsistent results, and that proceeding with the action at this time would result in a waste of the estate and of judicial time?

Statement of the Case

This is an appeal from the memorandum and order of the United States District Court for the Southern District of New York, Hon. Whitman Knapp, entered on April 14, 1976 (J.A.* 400) and the orders entered on May 6, 1976 (J.A. 430): 1) staying trial of the action as to certain defendants pending arbitration of the claims against them; 2) staying the action as to the Exchange and the other defendants pending conclusion of that arbitration; and 3) directing the parties to agree upon the appropriate arbitration tribunal, in default of which the Court would designate the American Arbitration Association.

This action was commenced against twenty defendants by the trustee in bankruptcy ("Allegaert") of duPont Walston Incorporated ("Walston"), which was a member organization of the Exchange until March 11, 1974. The complaint (J.A. 6) charges the defendants with alleged violations of the federal securities laws, bankruptcy law, the law of the States of New York and Delaware, and the common law. These violations were purportedly committed in connection with the realignment, in July 1973, of the businesses of Walston and duPont Glore Forgan Incorporated.

The Exchange is charged with conspiring with certain of the other defendants to defraud Walston, and with violating its duty under Section 6 of the Securities Exchange Act to regulate member organizations by allowing the realignment to proceed. The Exchange denies the truth of these allegations.**

Fifteen defendants, excluding the Exchange, moved for an order staying the action as to them, pending arbitration of the controversies comprehended by the complaint

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* "J.A." refers to the Joint Appendix.

** The Exchange has not answered the complaint pending determination of the stay issues.

(J.A. 68). This arbitration, they contended, is required by three separate agreements which are binding upon Allegaert. While the Exchange is not a party to any of the agreements, and concededly is unable to arbitrate, as a national securities exchange favoring arbitration to resolve disputes among its members it has endorsed the position of the arbitrating defendants.

The Exchange moved to stay the action as to it on the ground that the arbitration between Allegaert and the arbitrating defendants would resolve many of the issues pertaining to the Exchange, and, in fact, may render the action moot (J.A. 64). The Exchange argued that a denial of its motion would result in duplicative effort with a consequent waste of time and money for the Court and parties, and create the possibility of inconsistent results.

The Exchange's motion was based on the relationship between the charges made against it and those asserted against the arbitrating defendants. These charges involve many of the same transactions and occurrences. As a result, Allegaert must prove many of the same facts to prevail against either the arbitrating defendants or the Exchange, including such basic questions as the fairness of the realignment and the knowledge of Walston. The Section 6 claims against the Exchange can be reached only by determining, in the first instance, that the realignment was unjust and inequitable. If the realignment is found in arbitration to have been fair, the Exchange can not be held liable under any theory pleaded in the complaint. On the other hand, if Allegaert succeeds in arbitration, he can collect an award against the arbitrating defendants, and the action will be moot as a practical matter.

On April 14, 1976, Judge Knapp filed a memorandum and order granting the motions of the arbitrating defendants and the Exchange (J.A. 400). The Court, in a detailed and well reasoned opinion, concluded that Allegaert was required to arbitrate his claims, and exercised its discretion

to stay the action as to all other defendants. The Court granted the Exchange's motion to avoid "duplicative effort, the possibility of inconsistent results and the potential for unnecessary waste of the estate's limited assets." (J.A. 418). It observed that "[i]f the Exchange is correct that the arbitration will resolve many of the issues raised by this action, proceeding with the action while arbitration is pending would constitute waste of the estate and of judicial time as well. On the other hand, if the Exchange is wrong in that regard, nothing will have been lost." (J.A. 418). To avoid the possibility of any prejudice resulting from the stay, the Court provided for selective discovery pursuant to the Federal Rules of Civil Procedure "upon a proper showing of necessity. . . ." (J.A. 418-419).

ARGUMENT

I

The appeal from the order which grants the Exchange's motion for a stay should be dismissed because that order is not appealable.

An order granting a stay is not a final order under 28 U.S.C. § 1291. *Standard Chlorine of Delaware, Inc. v. Leonard,* 384 F.2d 304, 306 (2d Cir. 1967). Under certain circumstances, however, a stay of an action pending arbitration is analogous to an interlocutory injunction, and is appealable under 28 U.S.C. § 1292. *Baltimore Contractors, Inc. v. Bodinger,* 348 U.S. 176, 180 (1955).

> "An order staying or refusing to stay proceedings in the District Court is appealable under § 1292(a)(1) only if . . . the stay was sought to permit the prior determination of some *equitable* defense or counterclaim." *American Safety Equipment Corp. v. J. P. Maguire & Co.,* 391 F.2d 821, 824 (2d Cir. 1968).

The District Court's order granting the Exchange's motion for a stay fails to satisfy this requirement. The Exchange has not answered and cannot, therefore, be said to have pleaded an equitable defense or counterclaim, nor has it, as have the arbitrating defendants, set up the arbitration agreement which, admittedly, constitutes an equitable defense. *Standard Chlorine of Delaware, Inc. v. Leonard, supra.* The Exchange's motion was based, instead, upon the inherent power of the District Court to control its docket.

II

The District Court did not abuse its discretion by granting the Exchange's motion for a stay.

Even if the District Court's order granting the Exchange's motion were appealable, the order does not constitute error because it is not an abuse of discretion. The Supreme Court has held that the power to stay proceedings is "incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants. How this can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance." *Landis v. North American Co.,* 299 U.S. 248, 254-255 (1936). "[T]he District Court has a broad discretion in granting or denying stays so as to 'coordinate the business of the court efficiently and sensibly'." *McSurely v. McClellan,* 426 F.2d 664, 671 (D.C. Cir. 1970).

The decision to grant a stay may not be overturned unless "the limits of a fair discretion are exceeded...." *Landis v. North American Co., supra,* 299 U.S. at p. 256. Indeed, this Court has indicated that it will not interfere with a district court's exercise of discretion to control its docket, except upon a showing of actual and substantial prejudice. "The task of updating calendars is arduous,

complicated and burdensome. Since the trial judge must be entrusted with the power to alleviate calendar congestion, we shall not put obstacles in his way when he exercises his judgment wisely in achieving the desired goal." *Davis v. United Fruit Co.*, 402 F.2d 328, 332 (2d Cir. 1968), *cert. denied*, 393 U.S. 1085 (1969).

The power to stay is not limited to situations in which the parties to the two proceedings are the same or where the issues are identical. In *Nederlandse Erts-Tankersmaatschappij v. Isbrandtsen Co.*, 339 F.2d 440 (2d Cir. 1964), this Court, relying on *Landis v. North American Co., supra*, upheld a stay of the action as to all parties, including a non-arbitrating party, pending arbitration. The Court observed that while the power to stay is ordinarily exercised "in situations in which another proceeding was pending in the state courts, . . . a stay may also be appropriate where the pending proceeding is an arbitration in which issues involved in the case may be determined." (339 F.2d at p. 441).

This rule has been applied consistently by the courts in this Circuit. In *Lawson Fabrics, Inc. v. Akzona, Inc.*, 355 F.Supp. 1146 (S.D.N.Y.), *aff'd*, 486 F.2d 1394 (2d Cir. 1973), the district court granted a stay pending arbitration as to all parties, including a non-arbitrating party. The district court observed that:

> "The Second Circuit has laid down the standards for determining the appropriateness of granting a stay in Nederlandse Erts-TankerSmaatsch Appij. N.V. v. Isbrandtsen, *supra*, 339 F.2d 440, wherein they suggest that defendant must meet the burden of showing that (1) he will not hinder arbitration; (2) that arbitration will be concluded within a reasonable time; and (3) that delay will not work a hardship." (355 F.Supp. at p. 1151).

In *Liquifuels, Inc. v. Hess Oil and Chemical Co.*, 281 F.Supp. 596 (S.D.N.Y. 1968), the district court stayed all

proceedings pending arbitration between plaintiff and a third party. The Court, in granting the stay, was motivated by its desire "to avoid the unnecessary expenditure of time, effort and expense on the part of the Court, counsel and the litigants in an action that may soon be moot." (281 F.Supp. at p. 597).

The courts of New York have applied this reasoning and have stayed proceedings as to all parties in situations where only some are required to arbitrate. *Edwards v. Bergner,* 22 App. Div. 2d 808, 809 (2d Dep't 1964); *Lake Beechwood Country Club, Inc. v. Peekskill Manor, Inc.,* 2 App. Div. 2d 865 (2d Dep't 1956); *Dot's Boulevard Corp. v. Rosenfeld,* 285 App. Div. 425, 426 (1st Dep't 1955); *Bartley Bros. Construction Corp. v. National Surety Corp.,* 280 App. Div. 798, 799 (2d Dep't 1952); *Flash v. Goldman,* 278 App. Div. 829 (2d Dep't 1951); *Greene Steel & Wire Co. v. F. W. Hartmann & Co.,* 235 N.Y.S.2d 238, 242 (Sup. Ct. Kings Co. 1962), *aff'd,* 20 App. Div. 2d 683 (2d Dep't 1964).

Allegaert has failed to show how the District Court's stay as to the Exchange constitutes an abuse of discretion. He refers (Br.* 59-64) to the "erosion" of a federal forum, delay in administration of the estate, and loss of evidence as "real prejudice" which he will suffer as a result of the stay. Each of these arguments presumes that Allegaert will lose in arbitration and will ultimately pursue this action against the Exchange. Allegaert's speculation, however, is insufficient reason for allowing two actions involving the same issues to proceed simultaneously where one ultimately may suffice, and, in any event, fails to establish an abuse of discretion by the District Court.

Allegaert suggests that the only way in which a stay could save time for the parties or the Court "would be if the decision of the arbitrator would have collateral estoppel effect on the issues remaining to be tried in the district

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* "Br." refers to the appellant's brief.

court." (Br. 55). This, however, is simply not the case. In the event that Allegaert succeeds in arbitration and obtains a judgment against the arbitrating defendants for the full amount demanded in the complaint, there would be absolutely no reason for him to pursue this action against the Exchange. The arbitrating defendants are more than solvent and there is nothing to suggest that a judgment against them would go unsatisfied.

In the event that Allegaert loses either all or part of the arbitration, the arbitrators' findings could have a collateral estoppel effect in the action against the Exchange. While Allegaert has struggled to avoid the rule in this Circuit, it is clear that "[a] decision by arbitrators is as binding and conclusive under the doctrine of *res judicata* and estoppel as the judgment of a court. . . ." *James L. Saphier Agency, Inc. v. Green,* 190 F.Supp. 713, 719 (S.D.N.Y.), *aff'd,* 293 F.2d 769 (2d Cir. 1961). A party may not avoid the binding effect of arbitration after having had "the fullest opportunity to present [its] proofs. . . ." *Goldstein v. Doft,* 353 F.2d 484 (2d Cir. 1965), *cert. denied,* 383 U.S. 960 (1966).

Allegaert cites *Alexander* v. *Gardner-Denver Co.,* 415 U.S. 36 (1974), *Local 1114, Electrical Workers v. Honeywell Inc.,* 522 F.2d 1221 (7th Cir. 1975) and the *Restatement (Second) of Judgments* (Tent. Draft No. 1, 1973) (Br. 56-57) as authorities which caution against giving arbitration findings collateral estoppel effect. Allegaert's reliance, however, is misplaced. These authorities hold that collateral estoppel may be available depending upon the identity of issues, procedural fairness, and adequacy of the record. In *Alexander v. Gardner-Denver Co., supra,* the Supreme Court said:

> "We adopt no standards as to the weight to be accorded an arbitral decision, since this must be determined in the court's discretion with regard to the facts and circumstances of each case. Relevant factors include the existence of provisions in the [arbitration agreement] that conform substantially with [the

> statute involved], the degree of procedural fairness in the arbitral forum, adequacy of the record with respect to the issue . . ., and the special competence of particular arbitrators. Where an arbitral determination gives full consideration to [the issue at hand], a court may properly accord it great weight. This is especially true where the issue is solely one of fact, specifically addressed by the parties and decided by the arbitrator on the basis of an adequate record." (415 U.S. at p. 60, n.21)

In *Local 1114, Electrical Workers v. Honeywell Inc., supra,* the court questioned the *res judicata* weight to be given "the informal process of industrial arbitration," but acknowledged its availability in situations involving "strict factual identity" (522 F.2d at p. 1228). These cases do not deny collateral estoppel to arbitration findings, but merely suggest that their preclusive effect should be limited to appropriate circumstances. The *Restatement (Second) of Judgments,* cited by Allegaert, makes clear that the collateral estoppel value to be given should turn in each case "on an analysis of the comparative quality and extensiveness of the procedures followed. . . ." (Br. 57).

The Exchange takes no issue with these authorities. At the least, they demonstrate that Allegaert's argument regarding the collateral estoppel effect to be obtained from arbitration is premature. While arbitrators, concededly, are not required to record the reasons for their award, it is impossible to conclude that the arbitrators in this case will not set out, or that the record will not otherwise reflect, the reasons for the arbitrators' decision. Clearly, Allegaert's conjecture as to the detail of a not yet rendered award, made in connection with a not yet commenced arbitration, cannot outweigh the potential saving of time and effort to the District Court and the parties.

Allegaert argues that giving collateral estoppel value to the arbitrators' award is particularly inappropriate "in cases such as this where the claims asserted are securities

law claims entitled to be tried in federal court." (Br. 57), and would somehow erode Allegaert's right to a federal forum. This argument, however, was not urged below and may not be made for the first time on appeal. *Hormel v. Helvering,* 312 U.S. 552, 556 (1941); *First National Bank of Cincinnati v. Pepper,* 454 F.2d 626, 636 (2d Cir. 1972); *United States v. Vitasafe Corp.,* 352 F.2d 62 (2d Cir. 1965). Adherence to this principle "is particularly apt where . . . considerations underlying a subtle legal issue could have been exposed and distilled by the able district judge so as to facilitate more informed consideration by this court." *Terkildsen v. Waters,* 481 F.2d 201, 204-205 (2d Cir. 1973). While appellate courts have relaxed the rule upon a demonstration of exceptional circumstances, Allegaert has failed to make any such showing, and, indeed, could not.

In any event, this argument, even if it were considered, is unpersuasive. First, not all of the common claims against the Exchange and the arbitrating defendants are federal. Count X charges the Exchange and the arbitrating defendants with common law fraud. Second, appellant, having consented to arbitrate its securities law claims under three separate contracts, cannot avoid the consequences of its agreements, which include the potentially preclusive effect of arbitrators' findings in a subsequent proceeding. For this reason, the authorities cited by the appellant, which deny *res judicata* effect to state court determinations of exclusively federal matters, are inapposite. While all parties participating in an arbitration presumably accept the tribunal as sufficiently competent to resolve their controversy, a defendant in a state court action has no choice in the selection of its forum. Third, at least two courts of appeals, *Gardner v. Shearson, Hammill & Co.,* 433 F.2d 367 (5th Cir. 1970), *cert. denied,* 401 U.S. 978 (1971) and *Moran v. Paine, Webber, Jackson & Curtis,* 389 F.2d 242 (3d Cir. 1968), have given *res judicata* effect to the findings of arbitrators in connection with claims brought under the Securities Exchange Act of 1934.

Moreover, the authorities cited by Allegaert fail to prove his point. Virtually every case relied upon by him involves the appropriateness of arbitration of issues arising under the antitrust laws. *American Safety Equipment Corp. v. J. P. Maguire & Co., supra; Mach-Tronics, Inc. v. Zirpoli,* 316 F.2d 820 (9th Cir. 1963); *Ring v. Spina,* 148 F.2d 647 (2d Cir. 1945); *Varo v. Comprehensive Designers, Inc.,* 504 F.2d 1103 (9th Cir. 1974); *Cobb v. Lewis,* 488 F.2d 41 (5th Cir. 1974). These cases do not, as Allegaert suggests, stand for the general proposition that the trial of federal claims should precede arbitration (Br. 61), but, instead, turn on the uniqueness of the antitrust laws and on the fact that the agreement which provides for arbitration is itself usually the alleged antitrust violation. *American Safety Equipment Corp. v. J. P. Maguire & Co., supra,* the leading case cited by Allegaert, "does not mean that we rule out arbitration of all aspects of this dispute. It does mean that the district court erred in submitting to the arbitrators 'the issue as to the validity' of the [agreement providing for arbitration] insofar as that empowered the arbitrators to decide issues of antitrust law." (391 F.2d at p. 828). The Court was careful to note that it expressed "no general distrust of arbitrators or arbitration; our decisions reflect exactly the contrary point of view." (391 F.2d at p. 827). In this case, two of the three agreements requiring arbitration are the result of Walston's membership in national securities exchanges and bear absolutely no relation to the subject of this controversy.

The two securities cases cited by Allegaert demonstrate the weakness of his argument. *Shapiro v. Jaslow,* 320 F.Supp. 598 (S.D.N.Y. 1970), follows the rule first announced in *Wilko v. Swan,* 346 U.S. 427 (1953), that public customers cannot be compelled to arbitrate their federal securities law claims. This case, however, involves arbitration of the claims of a broker-dealer (Walston) and not of a public customer—a vital distinction which Allegaert seeks to avoid. While arbitration may be inappropriate for the claims of public customers, it is, as a matter of federal

law, the proper forum for the resolution of disputes between members of securities exchanges. *Coenen v. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *In re Revenue Properties Litigation Cases*, 451 F.2d 310, 313 (1st Cir. 1971); *Isaacson v. Hayden, Stone Inc.*, 319 F.Supp. 929, 930 (S.D.N.Y. 1970); *Brown v. Gilligan, Will & Co.*, 287 F.Supp. 766, 769-70 (S.D.N.Y. 1968). These cases establish the propriety of having federal securities claims between members of securities exchanges resolved in arbitration. Whatever the rule for other subject matters or types of plaintiffs, in disputes between broker-dealers, arbitration should precede trial. The second securities case cited by Allegaert, *Greater Continental Corp. v. Schechter*, 422 F.2d 1100 (2d Cir. 1970), like the first, is not between members of securities exchanges, and, moreover, was dismissed for lack of jurisdiction.

Allegaert's remaining arguments are even less compelling. His suggestion that evidence will be lost loses sight of the provision in the District Court's order entitling him to "apply to the court for permission to use the pretrial discovery procedures of the Federal Rules of Civil Procedure where circumstances warrant." (J.A. 431). Indeed, the District Court already has allowed discovery to proceed by permitting Allegaert to take the deposition of an ailing witness. This deposition was postponed only at the request of Allegaert's counsel, and ultimately could not be taken because of the subsequent deterioration in the witness' condition.

Allegaert's argument that administration of the estate would be needlessly delayed once again presumes that he will lose in arbitration and will have to pursue this action against the Exchange. If Allegaert wins in arbitration, or loses with collateral estoppel effect, proceeding with this action while arbitration is pending would constitute a clear waste of the estate. This Court has stated that:

> "[t]he policy of the Bankruptcy Act is best served by a conscious effort to reduce expenses of administration

to a minimum. See, e.g., Realty Associates Securities Corporation v. O'Connor, 1935, 295 U.S. 295, 55 S.Ct. 663, 79 L.Ed. 1446; Lane v. Haytian Corporation of America, 2 Cir., 1941, 117 F.2d 216; In re Realty Associates Securities Corp., 2 Cir., 1934, 69 F.2d 41, certiorari denied Bondholders' Committee v. Realty Associates Securities Corp., 1934, 292 U.S. 628, 54 S.Ct. 631, 78 L.Ed. 1482. And as a general rule no compensation or reimbursement [for the costs of pursuing a suit against the Exchange] can be had unless a tangible benefit has been conferred on the estate to the advantage of the creditors as a whole." *Saper v. John Viviane & Son,* 258 F.2d 826, 828 (2d Cir. 1958).

See also 11 U.S.C. § 104(a) (1967), to the same effect.

Conclusion

The order of the District Court granting the Exchange's motion for a stay is not appealable. The appeal from that order should be dismissed. Even if the order were appealable, the stay is not an abuse of the District Court's inherent discretionary power to control its docket, and the order should be affirmed.

September 13, 1976

Respectfully submitted,

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FOR THE SECOND CIRCUIT

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Defendants-Appellees,

and

DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,

Defendants.

- x

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

DIANE PERESS, being duly sworn, deposes and says:

I am over the age of 18 years and not a party to this action.

On September 13, 1976 I served two copies of the within brief on each of the attorneys listed below by depositing true copies thereof, securely enclosed in post-paid wrappers

addressed to each of the attorneys at their respective office addresses as set forth below, in a mailbox maintained by the Government of the United States at 1 Chase Manhattan Plaza, New York, New York 10005:

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Sworn to before me this
13th day of September, 1976.

Carlos Daniel Negron

CARLOS DANIEL NEGRON
NOTARY PUBLIC, State of New York
No. 24-4630273
Qualified in Kings County
Certificate Filed in New York County
Commission Expires March 30, 1978